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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,

vs.

FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

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QUESTIONS PRESENTED

1. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional under the foreign Commerce Clause.

2. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional where such application imposes discriminatory compliance burdens on such entities.

3. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, intrudes into an inherently federal area and is preempted by the United States Constitution.

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

PETITION FOR WRIT OF CERTIORARI

This petition for a writ of certiorari seeks this Court's review of the judgment of the Supreme Court of California on a nationally and internationally important matter relating to the limitations under the United States Constitution on the power of the states to apportion and tax the income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, under worldwide combined reporting.

OPINIONS BELOW

The opinion of the Supreme Court of California (Appendix A)[1] is reported at 2 Cal. 4th 708 (1992). The opinion of the Court of Appeal of the State of California in and for the Third Appellate District (App. B) was reported at 232 Cal. App. 3d 1187 (1990) and again at 3 Cal. App. 4th 1034 (1990) to permit tracking of the case pending review by the California Supreme Court. Pursuant to the California Rules of Court, Rule 976(d), the opinion of the Court of Appeal was vacated by the Supreme Court of California's grant of review on February 28, 1991. The Statement of Decision of the California Superior Court (App. C) is an unreported decision.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, the plaintiffs and respondents were Barclays Bank International Limited, a United Kingdom corporation, and Barclays Bank of California, a California corporation which was wholly owned by Barclays Bank International Limited. As appears in the Rule 29.1 Statement, Barclays Bank International Limited was merged with Barclays Bank PLC and Barcal was sold to Wells Fargo & Company with the present tax matters and claims for refund being assumed by Barclays Bank PLC.

RULE 29.1 STATEMENT

Pursuant to Rule 29.1 of the Rules of this Court, petitioner states during the income year 1977, Barclays Bank International Limited ("BBI"), a United Kingdom corporation, was a wholly owned subsidiary of Barclays Bank Limited ("BBL"), also a United Kingdom corporation. During income year 1977, Barclays Bank of California ("Barcal"), a domestic corporation, was a wholly owned subsidiary of BBI. On February 15, 1982, BBL reregistered as a public company under the provisions of the

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[1] All references to the appendices in this petition are denominated "App." followed by the letter to each item and, where necessary, a page reference.

Companies Act 1980 of the United Kingdom and changed its name to Barclays Bank PLC. On January 1, 1985, under the terms of the Barclays Bank Act 1984 of the United Kingdom, the United Kingdom banking business of Barclays Bank PLC was merged with the international and other overseas banking operations of BBI under the name Barclays Bank PLC. The ultimate parent of Barclays Bank PLC is now Barclays PLC, listed on the London Stock Exchange. On February 20, 1988, Barclays Bank PLC sold the stock of Barcal to Wells Fargo & Company. Under the terms of the agreement, Barclays Bank PLC assumed any tax liability at issue herein and retained all claims for refund. Barclays Bank PLC's non-wholly owned subsidiaries are listed in Appendix E to this petition.

JURISDICTION

The decision of the Supreme Court of California in these actions was rendered on May 11, 1992. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant portions of the following constitutional and statutory provisions are reproduced in Appendix D: Article I, Section 8, Clause 3 of the United States Constitution (the Commerce Clause); Article VI, Clause 2 of the United States Constitution (the Supremacy Clause); and California Revenue & Taxation Code Section 25101.

STATEMENT

The issues raised by this case — issues specifically reserved by this Court in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) — concern the powers of a state to tax a domestic corporation with a foreign parent, or a foreign corporation with either a foreign parent or foreign subsidiaries, under worldwide combined reporting. The precise question presented is whether California's application of worldwide combined reporting to Barcal, a domestic corporation with a foreign parent, and to

BBI, a foreign corporation with a foreign parent and foreign subsidiaries, is unconstitutional.

California's action already has caused serious national and international repercussions, and the United States has appeared as amicus curiae in the courts below to assert that this action is "patently unconstitutional."[2]

1. THE BUSINESS OF THE BARCLAYS GROUP.

In 1977 Barcal and BBI, the California taxpayers, were part of the Barclays Group, a United Kingdom banking group of over 220 corporations doing business in some 60 nations.[3] The ultimate parent, BBL (now Barclays Bank PLC), was one of the United Kingdom clearing banks. Only two of such subsidiaries (Barcal and Barclays Bank of New York) were incorporated in the United States and only one other subsidiary, BBI, also did business in the United States. The Barclays Group conducted over ninety-eight percent (98%) of its business outside the United States. The Barclays Group was and is involved in all phases of international banking, including retail, merchant, and commercial banking, leasing and consumer credit and finance.

BBI was a corporation organized under the laws of England and was domiciled and doing business in the United Kingdom. BBI also did business in over 33 nations and territories outside the United Kingdom including the United States. BBI operated a banking agency in California. BBI itself owned, directly or indirectly, more than fifty percent (50%) of over 70 subsidiary corporations which operated in approximately 34 nations and territories outside the United Kingdom. Barcal, a California banking corporation, was a wholly owned subsidiary of BBI.

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[2]The United States appeared as amicus curiae in the California Superior Court, Court of Appeal and Supreme Court. The brief filed in the California Supreme Court is reproduced at App. F.

[3]BBI and BBL agreed for purposes of the litigation that they were members of a worldwide unitary business for 1977. App. C at 42.

2. THE INTERNATIONAL STANDARD FOR DIVISION OF INCOME AMONG NATIONS FOR TAX PURPOSES.

The United States, the United Kingdom and other nations of the world divide the income of multinational enterprises among nations for tax purposes by the arm's length separate accounting method ("the arm's length method"). The arm's length method treats each corporation as "an independent entity dealing at arm's length with its affiliated corporations, and subject to taxation only by the jurisdictions in which it operates and only for the income it realizes on its own books." *Container*, 463 U.S. at 185. Where a corporation crosses national boundaries, the host (non-domiciliary) country taxes that corporation only on the profits earned in the host country and as if those profits were earned by a separate enterprise.

The United States has been a leader in establishing the arm's length method as the international standard. Both the United States and its trading partners use this standard in all bilateral tax treaties and in their internal tax laws. The standard is "universally used and favored" by the nations of the world both "as an ideal and as a working methodology." App. C at 20-21. The arm's length standard is the international practice. *Container*, 463 U.S. at 184.

California uses a different and incompatible method to divide the income of a multinational enterprise for tax purposes — worldwide combined reporting. This method aggregates the income of all entities which form a part of the unitary business wherever they do business and determines California's share of this aggregate income by a formula, generally the average of the property, payroll and sales within and without California.

California worldwide combined reporting requires worldwide tax information for all members of the unitary group, not just for taxpayers. The income allocated to a tax jurisdiction under the arm's length method can and does differ substantially from the income apportioned to that jurisdiction under worldwide combined reporting. There is no way to reconcile these differences.

Only a handful of states of the United States have ever used worldwide combined reporting. No *nation* uses worldwide combined reporting.

3. THE IMPACT OF CALIFORNIA'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO FOREIGN OWNED MULTINATIONALS.

In the early 1970's respondent first extended worldwide combined reporting to foreign owned multinationals. The extension of this conflicting method into the international arena brought immediate complaints from both foreign business and foreign governments. Foreign governments bombarded the United States government with formal and informal diplomatic protests about worldwide combined reporting as applied to foreign multinationals. These included diplomatic notes from virtually every developed country in the world, protestations from heads of nations including Prime Minister Thatcher of the United Kingdom, Prime Minister Nakasone of Japan, and Prime Minister Trudeau of Canada directly to the President, delay in Treaty negotiations by the Netherlands and West Germany, and strong representations from the French, Danish, Italian and German governments. The Canadian and French tax treaty negotiators insisted on an exchange of notes which called attention to their concerns and which obligated the United States to reopen discussions with each country if an acceptable solution could be devised. There were even unprecedented direct foreign government attempts at persuasion at the state level.

Finally, in 1985, after years of diplomatic effort, the United Kingdom enacted retaliatory legislation which would deny certain treaty benefits for United States corporations operating in unitary states. The legislation had a chilling effect on the willingness of United Kingdom subsidiaries of such corporations to repatriate dividends.

The Federal Executive has steadfastly promoted and adhered to a policy of the use of arm's length separate entity accounting for the division of international income and opposed the use of worldwide combined reporting through *all* administrations confronted with this issue. Initially, the United States added Arti-

cle 9(4) to the tax treaty then being negotiated with the United Kingdom.[4] Article 9(4) would have required states to use the arm's length method when taxing affiliates of United Kingdom companies. Although a reservation which would remove Article 9(4) from the Treaty was defeated in both the Senate Foreign Relations Committee and the full Senate, the majority vote of the Senate for the Treaty including Article 9(4) fell five votes short of the two-thirds majority necessary for ratification. The Treaty was resurrected after parliamentary maneuvering in which the reservation was added without a separate vote, and the Treaty, with the reservation, was ratified by the Senate.[5] The United Kingdom House of Commons ratified the Treaty only after strong assurances from the United States that the matter of worldwide combined reporting would be resolved. The United States has continued with efforts at resolution. The appearance of the United States as amicus curiae in all three California courts below in support of BBI and Barcal is a part of such efforts.

Congress has enacted no legislation dealing with this issue. Bills concerning unitary taxation have been introduced, but there has never been a vote in a congressional committee or in either house of Congress on such a bill. None of the bills has dealt solely with worldwide combined reporting as applied to foreign multinational enterprises.

4. THE ASSESSMENTS.

Respondent California Franchise Tax Board audited the California tax returns of BBI and Barcal for 1977 and determined that BBI and Barcal were part of a worldwide unitary business conducted by the members of the Barclays Group. Respondent assessed additional taxes of $4,076 to BBI and $254,699 to Barcal, subsequently reduced during the administrative process to $1,678 and $152,420, respectively. BBI and Barcal paid the additional assessed taxes and filed suit for refund, challenging the constitu-

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[4]The United States/United Kingdom Income Tax Convention is hereafter referred to as the US/UK Treaty or Treaty.

[5]The reservation was included in the Third Protocol to the Treaty which also contained other changes.

tionality of the application of worldwide combined reporting to foreign owned multinational groups.

5. THE PROCEEDINGS BELOW.

A. How the Federal Questions Were Raised and Passed On Below.

In their complaints and briefs in the California Superior Court, and in their briefs in the California Court of Appeal and in the California Supreme Court, BBI and Barcal contended, inter alia, that the foreign Commerce Clause of the United States Constitution precluded the application of worldwide combined reporting to taxpayers that are members of a foreign owned and controlled unitary group. These courts explicitly noted and ruled on these constitutional contentions.

B. The Decisions Below.

(i) California Superior Court and Court of Appeal.

The California Superior Court found and the California Court of Appeal affirmed, on the basis of substantial evidence,[6] that respondent's application of worldwide combined reporting to foreign owned multinational groups violated the foreign Commerce Clause because it "impair[ed] federal uniformity in an area where federal uniformity is essential" and "prevent[ed] the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448, 451 (1979) (hereafter the "one voice" test).

Both courts carefully considered, among other authority, *Japan Line*, 441 U.S. 434, *Container*, 463 U.S. 159, and *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986), and applied the dormant Commerce Clause analysis set forth in

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[6]Although there are some stipulations, App. C at 36 and 70, the case was tried on a contested record. The Statement of Decision of the Superior Court (App. C) explains the factual and legal basis for its decision as to each of the controverted issues at trial. Cal. Civ. Proc. Code § 632.

Japan Line and *Container* in reaching their decisions. Both courts rejected the contentions of respondent that five factors, by analogy to *Wardair*, showed a congressional policy "to permit the states to tax as they please" by "negative acquiescence" without congressional legislation.[7] Both courts held that these factors, only one of which even involved worldwide combined reporting,[8] were too general to evidence either the policy urged or congressional acquiescence to such policy. Both courts then tested the application of worldwide combined reporting in this case under the standards of *Japan Line* and *Container*:

- The most obvious foreign policy implication — the threat of offending our trading partners and leading them to retaliate (*Container*, 463 U.S. at 194) — was present.
- Worldwide combined reporting created automatic asymmetry in international taxation in that United States companies did not face worldwide combined reporting abroad.
- The legal incidence of the tax fell on a foreign corporation and its domestic subsidiary.
- The tax burden was more a function of the methodology than the tax rate.

Further the United States had appeared as amicus curiae to inform the courts of foreign policy implications. In light of these

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[7]The factors were: no coverage of state taxes in United States treaties or the United States Model Income Tax Convention, except in nondiscrimination clauses; failure of the Senate to ratify the US/UK Tax Treaty with Article 9(4); failure of Congress to enact legislation restricting state taxes; reservations to the OECD and UN Model Income Tax Conventions; and no coverage of state taxes in treaties of friendship, commerce, and navigation. The Court of Appeal noted that this Court had before it several of the same items in *Container* and still engaged in a dormant Commerce Clause analysis. App. B at 21.

[8]Failure of the Senate to ratify Article 9(4). Neither court could see how the expressed preference of a majority of the Senate to limit state taxes could, in the circumstances, be "transmogrified" into an affirmative policy endorsing such taxes.

distinctions between this case and *Container* and the radical differences between the arm's length international standard and worldwide combined reporting, both courts found that a direct adverse impact on foreign affairs from the use of worldwide combined reporting was "inevitable."[9]

Neither court, like "[this] court in *Container*," App. B at 21, found congressional expression one way or another and the Court of Appeal found a clear and thoroughly grounded policy of the Executive to require the arm's length method to divide income of foreign multinational enterprises. In the face of congressional inertia and inaction and in an area where the Executive has traditionally been given great deference,[10] the policy constituted a "clear federal directive." Thus, worldwide combined reporting in this context also violated the second prong of the *Container* "one voice" test.[11]

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[9]Although the Superior Court found both "definite risk of, as well as actual double taxation" in this case and characterized such double taxation as "more aggravated" in the "foreign multinational context," App. C at 25-26, it ruled worldwide combined reporting in this context did not fail the first additional test of *Japan Line* (double taxation) because double taxation was not "inevitable." The Court of Appeal affirmed.

[10]*See, e.g., United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); *Container*, 463 U.S. 159.

[11]The Superior Court also found de facto discrimination amounting to economic protectionism in that foreign based multinationals did not have readily available the necessary financial accountings from many of their foreign subsidiaries (without incurring substantial costs to create an accounting system solely for that purpose) to enable them to comply with worldwide combined reporting and concurrently to take advantage of certain benefits under California tax law. App. C at 26-28. Competitive enterprises not conducting business in other nations do not have this burden. The Superior Court also found that water's edge taxation, which is consistent with the custom of nations in taxing multinational enterprises, was a less intrusive alternative. App. C at 28. The Court of Appeal noted that, while it did not "use costs alone to constitutionally invalidate the use of [worldwide combined reporting] (see *Bibb v.*

The Superior Court also ruled that there was a violation of the due process clauses of the California and United States Constitutions:

> What does constitute a due process violation is the fact that all witnesses agreed that with customarily and currently available accounting data, literal compliance with [worldwide combined reporting] requirements is impossible for foreign multi-nationals such as Plaintiffs, and the only way to "comply" is by supplication and negotiation (absent an unduly burdensome cost of compliance).

App. C at 29. The Court of Appeal did not reach this issue.[12]

(ii) California Supreme Court.

In reversing the decision of the Court of Appeal, the California Supreme Court recognized that it was "presented with a question left open in *Container*, (*supra*, 463 U.S. at p. 189, fns. 26 & 32)," App. A at 3, but rejected analysis under the tests of this Court set forth in *Container* and *Japan Line*. Rather, the California court declared that *Wardair* had "reoriented" the dormant Commerce

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Navajo Freight Lines (1959) 359 U.S. 520, 526 . . .), this legal analysis [of the Superior Court] — based on a factual foundation of substantial evidence — demonstrates just how serious the administrative burden can be for the foreign entity." App. B at 26-27. The Court of Appeal determined on the basis of this evidence that California's allocation method rather than its rate was the primary source of difficulty and that foreign anger was even more understandable "in light of the critical role the United States has played in attempting to construct a coherent and nondiscriminatory tax policy for all nations" based on separate accounting. App. B. at 26.

[12]The Court of Appeal stated:

> Having decided that California's application of [worldwide combined reporting] (Rev. & Tax. Code, § 25101) to foreign-based unitary groups is unconstitutional under the foreign commerce clause of the federal Constitution, it is unnecessary for us to consider the plaintiffs' due process challenge.

App. B at 36-37.

Clause and had reduced the scope for dormant Commerce Clause analysis so as to make such analysis "particularly inappropriate" in this case. App. A at 20. Instead, "*Wardair* supplants what the court has termed the 'quagmire' of dormant commerce clause analysis ([*Northwestern States Portland Cement Co. v. Minnesota*], *supra*, 358 U.S. 450, 458) with a heightened judicial attentiveness to expressions of congressional foreign commerce policy." App. A at 21. From this perspective, the court "abstracted" this Court's analysis of the "textual materials" in *Wardair* "into a kind of protocol for identifying those kinds of governmental silences that give rise to 'negative implications' supporting an inference of federal acquiescence in the state tax under challenge." App. A at 23.[13]

The California court constructed its own test to determine whether a state tax violates the foreign Commerce Clause: whether in the absence of legislation, Congress' "inaction" constituted a "pattern of congressional action" which "evidences both an awareness of [the] issue and a refusal to adopt the remedy urged upon it." App. A at 39. The court took the same five items which the lower courts had rejected as evidences of congressional policy and under its new test treated them as "those kinds of governmental silences . . . [implying] federal acquiescence in the state tax under challenge." App. A at 23.[14]

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[13] For example, the court characterized the failure of treaties to address an international tax problem as to subnational taxes while addressing it as to national taxes as a "congressional policy choice" to permit subnational taxes.

[14] The California Supreme Court did not address the findings of both the lower California courts that there had never been a vote on any congressional legislation and that the bills introduced did not deal solely with the matter at issue. The court also determined that the preliminary votes on Article 9(4) by which a majority of the Senate would have restricted state power were not to be taken as any evidence of intent and that the final vote on the entire Treaty with Article 9(4) reserved was to be considered a "refusal" to curb the state. To overcome the fact that many of the tax treaties and all of the treaties of friendship, commerce, and navigation predated California's extension of worldwide combined

The California court concluded that the "clear federal directive" test in *Container* was not part of the dormant Commerce Clause analysis, but served only to determine whether Congress had acted to preempt an otherwise valid state tax. Thus, the Court of Appeal was incorrect in giving any consideration to executive action in formulating any such directive.

Further, since congressional acquiescence precluded resort to dormant Commerce Clause analysis, the "*Wardair* methodology interdict[ed] judicial resort to executive branch opinions as to the international commercial effect of a challenged state taxation practice . . . ." App. A at 21. Accordingly, the California court rejected the views of the United States, appearing as amicus curiae, that California's use of worldwide combined reporting interfered with the "Federal Executive's conduct of foreign affairs." App. A at 38 n.22.

Thus, the court did not consider the findings below of burden on commerce or the foreign policy implications in the application of worldwide combined reporting, including retaliation and threats of retaliation, but concluded that it was "adher[ing]" to this Court's "central meaning" in *Wardair* in holding that Congress' "refusal to legislate restrictions on state use of worldwide [combined reporting]" was not silence which triggered dormant Commerce Clause analysis. App. A at 39.

The California Supreme Court noted that the Court of Appeal had explicitly declined to decide the due process issue. Stating that "examination of the [due process] issue would profit from a consideration of its merits free of the view that a dormant foreign

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reporting to foreign owned multinational groups, so that failure to cover state taxes might not reflect a "policy choice" to permit this method, the California court assumed that this Court's 1924 decision in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924), on the constitutionality of formulary apportionment (but not worldwide combined reporting) and the application of worldwide combined reporting to domestic owned multinationals in the 1960's, evidenced Congress' (and the international community's) awareness of the possibility of worldwide combined reporting as an alternative to the arm's length standard. App. A at 32.

commerce clause analysis is appropriate in the circumstances present here," App. A at 39-40, the court remanded that issue to the Court of Appeal.

REASONS FOR TAKING THE CASE

This Court in *Container* specifically reserved the question in this case, the "constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." 463 U.S. at 189 n.26. Nevertheless, the California Supreme Court, perceiving a "diminution in the reach of dormant foreign commerce clause analysis," App. A at 4, held the very analysis used by this Court in *Container* inapplicable to resolve the question reserved. The California court fashioned a new test in Commerce Clause jurisprudence, permitting a court to disregard "sensitive matters of foreign relations and national sovereignty," *Japan Line*, 441 U.S. at 456, and to search instead for "those kinds of governmental silences that give rise to 'negative implications' supporting an inference of federal acquiescence in the state tax under challenge." App. A at 23. This conclusion is inconsistent with holdings of this Court on the application of the dormant foreign Commerce Clause. *See Japan Line*, 441 U.S. 434; *Container*, 463 U.S. 159. It is also irreconcilable with the decisions of this Court on the need for explicit congressional action to remove state laws which burden commerce from the reach of the Commerce Clause. *See Wyoming v. Oklahoma*, ____U.S.____, 112 S. Ct. 789 (1992); *Maine v. Taylor*, 477 U.S. 131 (1986); *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82 (1984); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982).

The limitation on a state's right to burden commerce is an important and recurring issue before this Court and a number of cases and administrative proceedings in California are dependent on the outcome of this case on this issue. *See* App. G. The decision, if left undisturbed, will stimulate aggressive unconstitutional taxation not just by California but by other states.

The issues presented here are of paramount national importance. The application of this tax method to foreign owned multinational businesses has already led to enactment of retaliatory legislation by the United Kingdom, threats of retaliation, and strong and continuing protests by all of the major trading partners of the United States. In its appearance as amicus curiae in all three California courts below, the United States has attested that the use of worldwide combined reporting in these circumstances is "an egregious interference with the Federal Executive's conduct of foreign affairs and is . . . patently unconstitutional." *See* App. F at 26 n.13.

The decision below erodes United States foreign economic policy by spreading confusion as to how the policy is formulated, confusion as to who speaks for the United States, and even confusion as to what that policy, based on a uniformly accepted international standard to divide income among nations for tax purposes, actually is.

This Court's review of this case is necessary to prevent erosion of federal policy. There are no jurisdictional barriers to review of the foreign Commerce Clause issues. The judgment of the California Supreme Court is final as to these issues, is not subject to further review and is already being applied by California. The foreign Commerce Clause issues are separable from and independent of the due process issue, and too important to be left unreviewed by this Court.

1. CALIFORNIA WORLDWIDE COMBINED REPORTING IS UNCONSTITUTIONAL UNDER THE FOREIGN COMMERCE CLAUSE. THE DECISION BELOW REWRITES ESTABLISHED FOREIGN COMMERCE CLAUSE JURISPRUDENCE AND IS INCONSISTENT AND INCOMPATIBLE WITH THIS COURT'S PRIOR DECISIONS.

Whether state taxes may permissibly burden commerce has been a recurring question before this Court.[15]

This Court has recognized that: "the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce." *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, ____U.S.____, 112 S. Ct. 2365, ____, 60 U.S.L.W. 4582, 4584 (1992) (citing *Japan Line*, 441 U.S. at 445-46). The reason for the broader protection of foreign commerce is that "matters of concern to the entire Nation are implicated. [*Japan Line*, 441 U.S.] at 448-451." *Kraft*, ____ U.S. at ____, 112 S. Ct. at ____, 60 U.S.L.W. at 4584. Discriminatory treatment of foreign commerce may create problems "such as the potential for international retaliation" that will concern and harm the Nation as a whole. *Id.*[16]

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[15] *See, e.g., Wyoming v. Oklahoma*, ____U.S.____, 112 S. Ct. 789; *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, ____U.S.____, 112 S. Ct. 2365, 60 U.S.L.W. 4582 (1992); *Container*, 463 U.S. 159; *Japan Line*, 441 U.S. 434.

[16] The same policies underlie the import-export clause. *See Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976) and *Japan Line*, 441 U.S. 434. The broader protection accorded to foreign commerce also requires stricter scrutiny in considering whether Congress has acted to permit such burden. *See South-Central Timber*, 467 U.S. 82.

A. This Court Has Established Criteria for Determining the Constitionality of State Taxes Under the Foreign Commerce Clause; the California Court Disregarded These Criteria.

Japan Line. Recognizing and stressing the need for uniformity in dealing with other nations when foreign commerce is implicated, this Court in *Japan Line* added two additional tests to the basic four part test[17] for determining whether a state tax unconstitutionally burdened commerce:

- whether the tax, notwithstanding apportionment, created a substantial risk of multiple taxation; and

- whether the tax impaired federal uniformity in an area where federal uniformity is essential and prevented the Nation from speaking with one voice when regulating foreign commerce.

Japan Line, 441 U.S. at 451. With respect to multiple taxation, this Court pointed out that "even a slight overlapping of tax — a problem that might be deemed *de minimis* in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Japan Line*, 441 U.S. at 456. A tax could prevent the Nation from speaking with one voice and frustrate achievement of federal uniformity by leading to international disputes over reconciling apportionment formulae, by creating asymmetry in the international tax structure leading to retaliation which causes harm to the Nation as a whole, not just to the state, and by increasing the potential for varying degrees of multiple taxation should other states follow the taxing state. *Japan Line*, 441 U.S. at 450-51.

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[17]The four part test applicable to all taxes implicating commerce, foreign and domestic, is: (1) the tax must be applied to an activity with a substantial nexus with the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

Container. *Container* involved the same California taxation method at issue here, worldwide combined reporting, but applied to a domestic owned multinational group. In *Container*, this Court reaffirmed the two additional *Japan Line* tests, but found constitutionally significant that double taxation was not an inevitable result of the California taxing scheme and that the tax fell not on foreign owners but on domestic corporations. Elaborating on the "one voice" inquiry, this Court stated that a state tax at variance with federal policy would fail the one voice standard if "it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Container*, 463 U.S. at 194. The most obvious foreign policy implication of a state tax was the "threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.* Recognizing its limited competence in determining precisely when foreign nations would be offended by particular acts, this Court established three "objective standards" in the absence of explicit action by Congress to determine when foreign nations would be offended and to permit the Court to decide how to balance the risk of retaliation against the sovereign right of the United States to let the states tax as they please. The standards reflected general observations about the imperatives of international trade and foreign relations. When applied in the factual context of *Container*, these factors did not lead to the conclusion that the California tax might justifiably lead to foreign retaliation: the tax did not create automatic asymmetry in international taxation; the tax fell not on a foreign entity but on a domestic corporation;[18] and, even if foreign nations had a legitimate interest in reducing tax burdens of domestic corporations, the amount of tax paid by the domestic taxpayer was more a function of the tax rate than the allocation

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[18]This Court also reserved the question of whether its analysis as to the importance of the incidence of the tax might be different if the taxpayer were a domestic subsidiary of a foreign corporation. *Container*, 463 U.S. at 189 n.26.

method. This Court also noted the absence of a brief by the Executive branch.[19]

Tested by these same factors, worldwide combined reporting applied to members of a foreign owned multinational group, as here, is unconstitutional. Worldwide combined reporting clearly implicates foreign policy issues which must be left to the federal government and prevents the Nation from speaking with one voice.[20] This Court need not speculate as to foreign offense: in this case there is actual retaliation as well as threats of retaliation. There is automatic asymmetry in international taxation as United States corporations are not subjected to worldwide combined reporting by any nation. The California tax falls on a foreign corporation as well as on the domestic subsidiary of a foreign corporation. The amount of tax paid is a function of the allocation method, not the tax rate. Finally, the United States has appeared as amicus curiae in all three California courts.

The California Supreme Court never tested worldwide combined reporting by the standards set forth in *Container* and *Japan Line* because it held that changes in this Court's Commerce Clause jurisprudence made such analysis inappropriate.

The California Supreme Court further held that the "clear federal directive" prong of *Container* was not a dormant Com-

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[19]Chief Justice Rehnquist notes in his dissent in *Kraft* that the domestic nature of the petitioner and the absence of a United States amicus brief were the distinctions between *Container* and *Japan Line*. *Kraft*, ___ U.S. at ___, 112 S. Ct. at ___, 60 U.S.L.W. at 4586.

[20]Petitioner contends that worldwide combined reporting applied to taxpayers which are members of a foreign owned multinational group also violates the first additional test, enhanced risk of or actual double taxation. The California Superior Court found actual double taxation and enhanced risk of double taxation in this case but, following *Container*, held that such double taxation was not inevitable. App. C at 25-26. Whether the *Container* requirement of "inevitability" would apply in the circumstances of a taxpayer which is a member of foreign owned multinational business has not been decided and should also be resolved by this Court.

merce Clause test and applied only to invalidate otherwise valid state taxes. It thus avoided the question of whether worldwide combined reporting in these circumstances was fatally inconsistent with federal policy, the more relaxed "species of preemption" standard adopted by this Court in *Container*, 463 U.S. at 194. It also avoided any consideration of the role of the Executive in formulating federal policy on the ground that only Congress played any role in creating such policy.

This Court should affirm that dormant Commerce Clause analysis remains applicable and appropriate, decide the reserved question in *Container*, and give guidance on the scope and application of the "clear federal directive" test.

B. The Decision Below Contradicts the Conclusions of This Court in *Container*.

This Court in *Container* held that failure of treaties to cover subnational taxes or to restrict states to the arm's length method, failure of the Senate to pass the US/UK Treaty with a provision which would have restricted state use of a non-arm's length method, and failure of Congress to enact legislation restricting state taxation did not constitute "specific indications of congressional intent." *Container*, 463 U.S. at 196. The California court determined that these same items constituted evidences of congressional "acquiescence" amounting to ratification of the use of worldwide combined reporting. App. A at 34. If such items evidence a congressional policy sufficient to remove this case from the dormant Commerce Clause, presumably this Court would not have bothered with the balance of its analysis in *Container*. This contradiction illustrates the confusion created by the California court in its search for negative acquiescence. Essentially, the California court is holding that the *Wardair* case, on which it rests its new test, has overruled *Container* sub silentio. This Court should resolve this conflict.

C. The Ruling of the California Court Is Irreconcilable with This Court's Standards for Determining Whether Congress Has Acted To Permit a State To Burden Commerce.

This Court has consistently held that, to exempt a state tax or other regulation which burdens commerce from scrutiny, "Congress must manifest its unambiguous intent before a federal statute will be read to permit or approve of such a violation of the Commerce Clause . . . ." *Wyoming v. Oklahoma*, ___U.S. at ___, 112 S. Ct. at 802. *See also Maine v. Taylor*, 477 U.S. at 139; *South-Central Timber*, 467 U.S. at 91; *Sporhase*, 458 U.S. 941. This Court, in *South-Central Timber*, has further stated that the need for "affirmative approval" of the state statute or regulation is "heightened" when the statute has "substantial ramifications beyond the Nation's borders." 467 U.S. at 92 n.7.[21]

In fact, the "burden [is on the state to] demonstrat[e] a clear and unambiguous intent on behalf of Congress to permit the discrimination against interstate [and foreign] commerce . . . ." *Wyoming v. Oklahoma*, ___U.S. at ___, 112 S. Ct. at 802.

This Court has held that such intent was not demonstrated by reservation to the states of the regulation of local utility rates in the Federal Power Act (*Wyoming v. Oklahoma*), consistency of the state regulation with federal legislation (*South-Central Timber*), deferral by Congress to state law in thirty seven statutes (*Sporhase*), or approval by Congress of several interstate water compacts (*id.*). The congressional enactment must be "an affirmative grant of power to the states to burden . . . commerce 'in a manner which would otherwise not be permissible.' *Southern Pacific Co. v. Arizona ex rel. Sullivan*, [325 U.S. 761,] 769." *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982). These cases presuppose some federal enactment which demonstrates such affirmation. Here there is no such enactment.

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[21]The reason that "congressional authorization not be lightly implied" is the need for a consistent and coherent foreign policy which is the exclusive responsibility of the federal government. *South Central-Timber*, 467 U.S. at 92 n.7.

The California court's approach eliminates the threshold inquiry of burden on commerce and the evidentiary burden on the state to show the "clear and unambiguous intent" of Congress to permit a violation of the Commerce Clause. Rather, the California court would assume a tax valid unless Congress says "no."

The decision below cannot be reconciled with the decisions of this Court on removal of state action from Commerce Clause scrutiny. The decision is an invitation to state taxation unrestrained by constitutional limitations.

D. The Decision Below Is Inconsistent with This Court's *Wardair* Decision.

Wardair concerned a state sales tax on a discrete transaction (purchase of fuel in Florida) occurring only within one national jurisdiction. The case had neither actual nor possible international multiple taxation. After strongly reaffirming the policies of the dormant Commerce Clause, this Court determined that the federal policy urged by the petitioner, reciprocal tax exemptions for aircraft, did not exist. On the contrary, "in the context of this case," the evidence demonstrated that the federal government had "affirmatively acted, rather than remained silent, with respect to the power of the state to tax aviation fuel." *Wardair*, 477 U.S. at 9. This Court found congressional action constituting law in the Chicago Convention, a treaty entered into by the United States and 156 other nations, which by its terms precluded the imposition of local taxes on fuel in certain circumstances but did not prohibit the taxation of fuel in the circumstances before the Court. This text demonstrated:

> the international community's awareness of the problem of state and local taxation of international air travel, specifically aviation fuel, and represent[ed] a decision by the parties to that Convention to address the problem by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority.

Wardair, 477 U.S. at 10. Subsequent treaties, including the United States/Canadian Treaty,[22] dealt only with national taxes, leading to the inference that Congress had "negatively acquiesced" in the Florida tax.

This Court explicitly said not only that it was not addressing, but also that "nothing in this opinion should be understood to address, whether, in the absence of these international agreements, the Foreign Commerce Clause would invalidate Florida's tax." *Wardair*, 477 U.S. at 13. Nevertheless, the California court seized on the decision as heralding a change in this Court's dormant foreign Commerce Clause jurisprudence. The California court's new test, congressional "refusal" to act while aware of the problem, does not appear in *Wardair*.[23] This Court proceeded in *Wardair* against an extensive background of enacted congressional legislation — the Federal Aviation Act domestically and the Chicago Convention internationally — both of which dealt with state sales taxes and the latter with state sales taxes on aviation fuel. Here there is no seminal statute or other enactment which addresses the specific problem.

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[22]The Canadian provinces also were applying a tax similar to that imposed by Florida, an indication that there was no uniform policy against such taxes.

[23]Other than Article 9(4) of the US/UK Treaty, none of the items which the court below used as evidence of awareness and refusal even deals with worldwide combined reporting applied to foreign multinational groups. Under the California court's approach, the stalemate created by the minority in the Senate over Article 9(4) becomes an explicit "refusal" to act evidencing Congress' exercise of its "power . . . [t]o regulate Commerce with foreign Nations . . . ." U.S. Const. art. I, § 8, cl. 3.

2. THE DECISION BELOW UNDERMINES ESSENTIAL CONSTITUTIONAL RESTRAINTS ON STATE POWER TO INTERFERE IN THE CONDUCT OF FOREIGN POLICY, AND, IF LEFT UNDISTURBED, THREATENS SERIOUS HARM TO THE NATION.

The decision below has implications far beyond the question of constitutionality of worldwide combined reporting as applied herein. The California court proceeds on the assumption that *Wardair* presages a diminution in the reach of the dormant foreign Commerce Clause.[24] Although it recognized that foreign governments objected strenuously to the practice of worldwide combined reporting and that "executive branch officials charged with conducting American foreign commercial policy agree[d] with them," App. A at 37 n.21, the California court used the alleged diminution as its predicate for ignoring both the United States and the foreign governments. Given the importance of foreign Commerce Clause jurisprudence, which concerns "sensitive matters of foreign relations and national sovereignty," *Japan Line*, 441 U.S. at 456, this Court should clarify that there is no such diminution.

The California court's substitute test, if left to stand, would lead to serious harm to the Nation. A recurring theme in this Court's decisions on foreign commerce issues is concern over harm to the nation as a whole from state actions which may lead to retaliation. *Japan Line*, 441 U.S. 434; *Container*, 463 U.S. 159; *Kraft*, ___ U.S. ___, 112 S. Ct. 2365, 60 U.S.L.W. 4582; *Chy Lung v. Freeman*, 92 U.S. 275 (1875). These decisions recognize that all nations have a proper concern for the well being of their nationals, that nations do not take these concerns lightly, that response is a national, not a state, responsibility and that states have no role in the process. *Hines v. Davidowitz*, 312 U.S. 52

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[24]The California court refers to this Court's "recent foreign Commerce Clause jurisprudence" but relies only upon *Wardair*. The decision below was issued prior to *Kraft*, ___ U.S. ___, 112 S. Ct. 2365, 60 U.S.L.W. 4582.

(1941); *Zschernig v. Miller*, 389 U.S. 429 (1968); *Japan Line*, 441 U.S. 434.

The decision below, however, trivializes nation-to-nation initiatives to resolve conflicts, including such efforts as those in this case to have the states voluntarily cease use of the apportionment method.[25] Patience by nations is viewed by the California court as further evidence of congressional acquiescence. If any test is destined to lead to retaliation by foreign governments, it is the California court's new test.

The decision of the court below, if left unreviewed, would emasculate the Federal Executive in foreign affairs any time a state chose to interfere and Congress did not enact legislation curbing the state. The "one voice" test proceeds from the strong presumption of the need for federal uniformity in the area of foreign commerce. *Japan Line*, 441 U.S. 434; *Wardair*, 477 U.S. 1. However, the California court would silence the Executive[26] and in the silence of Congress permit a cacophony of state voices. How are our foreign trading partners to discern the foreign policy of the United States if there is no text? Who can tell our foreign trading partners what that policy is? Can our foreign trading partners rely upon the responses of the Executive? Is this not exactly the situation which will lead to retaliation and harm to the nation as whole?

The issue is even more serious since it is the United States that has been the leader in establishing the international standard. The

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[25]The California court calls the results of such efforts "meliorative measures designed to pacify critics," App. A at 36, a clear invitation to the states to revoke such "measures" when they tire of "pacification."

[26]The Federal Executive has substantial power in the area of foreign affairs. *Curtiss-Wright Export*, 299 U.S. 304; *United States v. Pink*, 315 U.S. 203 (1942); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952). In the absence of congressional action, executive action, particularly, as here, against a backdrop of enacted national policy designed specifically to deal with international division of income, is entitled to great weight. *Youngstown Sheet*, 343 U.S. 579; *Dames & Moore v. Regan*, 453 U.S. 654 (1981).

standard forwards the long established and overarching United States foreign economic policy to open markets and remove barriers to trade. United States business benefits from this standardization. Other nations will not long tolerate increased taxes on their nationals from this aberrant system, increased burdens of compliance arising from the requirement of their nationals to respond to two separate systems to divide and report their international income among competing jurisdictions, and possible impact on their fiscs without retaliating against American business.[27]

If a state of the United States which is economically the equivalent to the seventh or eighth largest nation in the world is permitted to promote its incompatible and inconsistent tax system, how can the United States seek the cooperation of its trading partners in adhering to the international standard.

3. THIS COURT'S REVIEW IS ESSENTIAL TO PREVENT EROSION OF IMPORTANT FEDERAL POLICIES; THERE ARE NO JURISDICTIONAL BARRIERS TO REVIEW OF THIS CASE.

California's use of worldwide combined reporting in these circumstances is undermining the federal economic policy of promoting a uniform standard for division of income for tax purposes between nations. In addition to removing trade barriers, the federal policy promotes the management of conflict and the mitigation of double taxation, and encourages American trade and competitiveness. Left unreviewed, the judgment of the California court, by perpetuating and encouraging worldwide combined reporting, or any other aberrant method of dividing international income, will continue the erosion of this important federal policy. Moreover, the California court's judgment introduces new confusion into Commerce Clause jurisprudence, and draws into question this Court's settled policy of exhibiting greater sensitivity in matters of international concern. *See Japan Line*, 441 U.S. at 448-51; *Kraft*, ___ U.S. at ___, 112 S. Ct. at ___, 60 U.S.L.W. at 4584. It would be "intolerable to leave unanswered" this important constitutional question with national

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[27]The United Kingdom already has.

and international implications. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 484-85 (1975) (quoting *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 247 n.6 (1974)).

No jurisdictional barriers to this Court's review of this case exist. The judgment of the California Supreme Court, that worldwide combined reporting did not violate the foreign Commerce Clause when applied to apportion the income of foreign-owned multinational business, meets the criteria established by this Court for finality under 28 U.S.C. § 1257 where further state proceedings may occur. *Cox*, 420 U.S. at 476-87. The judgment is of the highest California court, is not subject to further review in California and is binding on all lower California courts.

That the further state proceedings may involve a federal question (i.e., the due process issue) is not determinative. This Court has shown a willingness to hear cases with unresolved federal issues in certain circumstances. *Hudson Distribs., Inc. v. Eli Lilly & Co.*, 377 U.S. 386 (1964); *see also Flynt v. Ohio*, 451 U.S. 619 (1981). The circumstances of this case warrant immediate review of the foreign Commerce Clause issues. These issues are separable from the issue remanded and will not be affected by any proceedings on the remand.[28] The foreign Commerce Clause issues are "too important to be denied review and too independent [of the remanded issue] to require that appellate consideration be deferred until the whole case is adjudicated." *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 546 (1949). A favorable decision by this Court on the issue decided by the California Supreme Court will dispose both of this and of other pending litigation.[29] On the other hand, if this Court were to deny review

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[28]Unlike the eminent domain cases discussed in *Cox*, 420 U.S. at 477-78 n.6, where the two federal questions are part of an integral problem, the due process issue is not integral to or any part of the foreign Commerce Clause issues.

[29]That a decision in petitioner's favor on the foreign Commerce Clause issues will dispose of the case is shown by the fact that the California Court of Appeal found it unnecessary to reach the due process issue after ruling in petitioner's favor on the issues presented

and if petitioner were to prevail below, the foreign Commerce Clause issues may be mooted and these important questions would not reach this Court. *See Cox*, 420 U.S. at 482-83.

This Court has stated on numerous occasions that the rule of finality is to be given a practical rather than a technical interpretation. *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 152-53 (1964); *Cohen*, 377 U.S. at 546. In making this practical determination, this Court has stated that where "refusal immediately to review the state-court decision might seriously erode federal policy, [this] Court has entertained and decided the federal issue, which itself has been finally determined by the state courts for purposes of the state litigation." *Cox*, 420 U.S. at 483. The policies at stake here surely merit this Court's attention.

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here. In addition, a number of cases await the outcome of this case, but only on the foreign commerce "one voice" issue. Respondent required waiver of all issues except the "one voice" issue in cases seeking a deferral. *See* App. G.

CONCLUSION

This Court has established a framework for analysis of state taxes which may burden foreign commerce. The California court has not only jettisoned the analytical framework created by this Court in *Japan Line* and *Container*, it has essentially embraced an approach which this Court has rejected many times, namely that the states are free to tax until Congress tells them to stop. *See, e.g., Japan Line*, 441 U.S. at 454-55; *Southern Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 769 (1945). The decision below cannot be reconciled to the principles established by this Court and it carries grave dangers of harm to the Nation. For the foregoing reasons this Court should grant this petition for Writ of Certiorari.

Respectfully submitted,

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